



Fiscal Reform

Background

The City of San Diego's \$743 million General Fund benefits from a variety of revenues that involve state appropriation or authorization:

<u>Source</u>	<u>Amount (FY04)</u>	<u>% of GF</u>	<u>State Discretion</u>
Property Tax	\$199.7 million	26.9%	Allocation Formula
Sales Tax	\$191.5 million	25.8%	Allocation Formula
Motor Vehicle Fees	\$ 74.9 million	10.1%	VLF fee setting/Backfill
Total	\$466.1 million	62.7%	

Significant additional funding results from:

- Redevelopment Tax Increment
- Public Library Foundation
- Public Safety grant programs
- Transportation taxes
- Proposition 172 local sales tax

The Government Relations Department, in partnership with Financial Management, has inaugurated a review of the State-local financial relationship, including:

(1) **Local Control:** Revenues due to local government have been confiscated or delayed on several occasions by legislative direction. The majority of these funds have never been returned to local government - even when state revenues increased.

- Educational Revenue Augmentation Fund (ERAF): The FY 1992 State budget confiscated property taxes previously dedicated to local government and redirected them to the State General fund for purposes of funding education. On an annualized basis, this transfer costs the City of San Diego roughly \$30 million a year.
- FY 04 budget "loaned" \$12.6 million from the City of San Diego to the state until FY 06
- FY 04 budget "loaned" over \$100 million in transportation funds to the San Diego region to the state until FY 09.
- Disagreements between the Legislature and two separate Governors over the Vehicle License Fee have resulted in delay of between \$12.6 and \$17million in revenues by

up to 2 years, and, left cities with uncertain cash flow expectations for months at a time.

- (2) **Distribution Formulas:** State and regional funding streams are often distributed by formulas. These formulas require review to ensure that they provide fair and equitable treatment to the City of San Diego.
- (3) **Tax Policy:** State, regional and local tax policy require review for purposes of identifying critical policy decisions or assumptions. Examples include taxation of internet retail sales and sales of services; and the impact of tax policy on “smart growth”.

State Government Issues

Local Control:

- **League of California Cities Initiative:** This voter initiative would require the State Legislature to gain a vote of the people before transferring funds normally received by local government to state purposes. The initiative has been certified by the Attorney General for circulation, and, signatures are now being collected to place the initiative on the November, 2004 ballot. Mayor Murphy and Council Member Madaffer have already endorsed the initiative.

Recommendation: Establish SUPPORT position for League Initiative by City of San Diego

- **Vehicle License Fee:** Due to the roughly \$8 billion structural imbalance of the State budget, full funding of the Vehicle License Fee Backfill account is anticipated to be an important component of the FY 05 budget debate.

Recommendation: Establish protection of VLF revenues as highest fiscal priority for Government Relations department and its state consultants

- **Booking Fees:** Due to the roughly \$8 billion structural imbalance of the State budget, full funding of the Booking Fee Account is anticipated to be an important component of the FY 05 budget debate.

Recommendation: Establish protection of Booking Fee revenues as second highest fiscal priority for Government Relations department and its state consultants.

Distribution Formulas

- **Property Tax Allocation Equity:** Prior to 1978, each local jurisdiction (which could include a city, county, local school district, and any special districts that provided services to a property) levied a property tax that was independent of the rate set by any other jurisdiction. The property tax rate paid by a property-owner was the sum of the individual rates set by each taxing entity.

In 1978, California voters passed Proposition 13, limiting the aggregate property tax rate to 1% of assessed valuation. That same year, Senate Bill 154 established a method of property tax allocation for the revenues generated by the 1% among jurisdictions sharing a property tax base as the percentage share it received of the total property taxes prior to Proposition 13. Thus, jurisdictions that received a relatively smaller share of total property tax revenues within a county before Proposition 13 now receive the same percentage share.

Recommendation: Direct Government Relations Department and Financial Management to report recommendations regarding equity issues relating to this distribution formula to Rules Committee not later than February, 2004

- **Proposition 172:** Following confiscation of local government revenues in the 1991 state budget, the Governor and Legislature authorized local governments to add up to ½ cent of sales tax to benefit public safety, with approval by local voters. The most recent figures available for allocation of these revenues:

Total County Revenues:	\$18.8 million	
Shares:		
County of San Diego	\$17,725 million	94%
City of San Diego	\$598,000	3%
Other Cities	\$463,000	2.5%

Recommendation: Direct Government Relations Department and Financial Management to review allocation formula and report recommendations to Rules Committee not later than February, 2004

Tax Policy

Tax Revenue “Swap” Proposals: A variety of organizations have announced, or are preparing, proposals to address issues of tax policy, including: making internet retailers subject to the sales tax, swapping property taxes for sales taxes to encourage smart growth, per-capita distribution of sales tax to encourage smart growth and revenue stability. These reviews include:

- Governor’s Fiscal Reform Commission (Leon Panetta): Variety of issues
- Commission on Taxation in the 21st Century: Variety of issues
- Campbell-Steinberg Legislation: Sales Tax distributed per capita
- Hertzberg Proposal: Cities trade sales and VLF taxes for property taxes
- State Legislative Committees: To be determined
- San Diego Association of Governments (SANDAG): Cities trade VLF, sales and homeowners exemption for property

Recommendation:

- Establish a presumptive position of Oppose to proposals that alter the sales tax distribution basis from *situs* to per capita – a shift that reduces City revenues by \$15 million annually
- Support state legislation requiring California to participate in the development of national uniform Internet Taxation standards
- Establish SUPPORT position for proposals that exchange property tax revenues for local government in return for sales tax revenues, if accompanied by:
 - Adequate growth
 - Appropriate cash flow schedule
- Direct the Government Relations Department, in partnership with Financial Management, to report recommendations to the Rules Committee by March on the following issues:
 - Governor's Fiscal Reform Commission (Leon Panetta)
 - Commission on Taxation in the 21st Century:
 - Campbell-Steinberg Legislation
 - Hertzberg Proposal
 - 2003 State Legislative fiscal reform initiatives
 - San Diego Association of Governments (SANDAG) proposal

Federal Government Issues

Tax Policy

Recommendation: Direct Government Relations Department, in partnership with Financial Management, to include issues relating to internet retail sales taxes in its March, 2004 report to Rules Committee regarding state tax policy issues.

Appendix A: Criteria for State/local fiscal relationship & revenue source selection

Volatility

- Economic Stability:
- Most Stable: Property tax?
- Mixed: Sales Tax?
- Unstable: Income taxes?
- Cities have virtually no ability to address revenue fluctuations – because voter approval is required for nearly all revenue sources.

Equity

- Proposition 172 distribution formula
- AB 8

Public Policy

- Fiscalization of land use: Cities currently receive 11 times more revenue from retail development than housing
- Local Control

Appendix B: Revenue Sources

The City of San Diego's \$729.3 million General Fund benefits from 3 sources that involve State government:

Source	Amount (FY04)	% of GF	State Discretion
Property Tax	\$199.7 million	26.9%	Allocation Formula
Sales Tax	\$191.5 million	25.8%	Allocation Formula
Motor Vehicle Fees	\$ 74.9 million	10.1%	VLF fee setting/Backfill
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State Sales Tax: The sales tax for the County of San Diego:

<u>Amount</u>	<u>Purpose</u>
4.75%	State General Fund
.50%	State Local Revenue Fund
.50%	State Collection for Local Public Safety Fund
1.25%	Local Sales Tax
	1% City and County Operations
	.25% County Transportation Funds
.50%	TransNet (Expires 2007)
7.5%	Total

Funding for city and county operations are distributed *in situs*, meaning that the city in which the tax is imposed benefits from the revenue.

Property Tax: Property taxes are collected at the rate of X, and distributed as follows:

State Educational Revenue & Augmentation Fund (ERAF)	63%
County	14%
City	13%*

The rate at which the City (& County?) distribution rate are established was adopted in 1975. Other cities receive up to X% of these funds. Each 1% equals approximately \$X on an annual basis.

Other forms of State Funding:

- Booking Fees \$5.2 million
- Homeowners Exemption \$?

Redevelopment: When redevelopment agencies are established, property tax increment for 20 years is dedicated to the redevelopment agency. The State agrees to forego that revenue in return for the requirement that 20% of the revenues are dedicated to low/moderate income housing.